LC Paper No. CB(1)465/04-05(01)

Bills Committee on Companies (Amendment) Bill 2004

Summary of submissions
(Position as at 14 December 2004)

Twelve submissions

	LC Paper No.
W H Lam & Company (Lam & Co)	CB(1)453/04-05(01)
The Hong Kong Mortgage Corporation Limited (HKMC)	CB(1)453/04-05(02)
The Chinese General Chamber of Commerce (CGCC)	CB(1)453/04-05(03)
Securities and Futures Commission (SFC)	CB(1)453/04-05(04)
The Association of Chartered Certified Accountants (ACCA)	CB(1)453/04-05(05)
The Association of International Accountants (Hong Kong Branch) (AIA(HK))	CB(1)453/04-05(06)
The Standing Committee on Company Law Reform (SCCLR)	CB(1)453/04-05(07)
The Hong Kong Institute of Company Secretaries (HKICS)	CB(1)453/04-05(08)
The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies (DTCA)	CB(1)453/04-05(09)
The Company & Financial Law Committee, Law Society of Hong Kong (Law Soc)	CB(1)453/04-05(10)
Linklaters	CB(1)453/04-05(11)
Mr David M WEBB	CB(1)453/04-05(13)

Bills Committee on Companies (Amendment) Bill 2004

Summary of views raised by organizations/individuals on the Bill

(Position as at 14 December 2004)

	Views of organizations on major issues of the Bill	Name of Organization/ Individual
1	***General comments***	
1.1	Supports the Bill.	HKICS Linklaters
1.2	● Supports the Bill. The proposal to amend the definition of "subsidiary" in the Companies Ordinance (CO) for the purposes of group accounts will enhance the comprehensiveness of financial reporting and corporate governance of companies. ● The Bill is not expected to have significant impact on Hong Kong companies. As there are differences in the accounting practices between Hong Kong and the Mainland, some Mainland companies may have difficulties in complying with the new requirements. The Administration should carefully consider the impact of the proposed amendments in this aspect.	CGCC
1.3	Agrees in principle that the proposed amendments to the CO serve to make the financial statements prepared in accordance with the CO more comparable to those prepared in accordance with the International Accounting Standards (IASs).	AIA (HKB)
1.4	● Supports the proposal to make the definition of "subsidiary" in the CO more closely in alignment with the IASs. This will facilitate investors and analysts in comparing accounts of companies from different jurisdictions, and reduce accounting costs of multi-national groups. ● In the long run, overlap or repetition between the Hong Kong Accounting Standards (HKASs) and the CO should be removed to avoid the need of making frequent amendments to the Ordinance as the accounting standards evolve.	David WEBB

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	● The areas of overlap between the CO and HKASs can be replaced with a statutory obligation to conform to requirements of HKASs. The legislature should retain the powers to require (through the CO) accounting disclosure by companies beyond HKASs, provided that the additional disclosure is not inconsistent with HKASs.	
1.5	Expresses no comment on the Bill.	SFC SCCLR DTCA
2	***Power to amend the proposed new section 2B(3) of the CO (clause 2)***	
2.1	Under the proposed new section 2B(4) of the CO, the Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend subsection (3). Any changes to the meaning of "subsidiary" could have significant consequences and should require legislative oversight, and should not be left to the Administration.	Law Soc
3	***Definition of "subsidiary"*** ***(clause 2 and the Twenty-Third Schedule to the CO)***	
3.1	● The proposed amendments to entrench the current definition of "subsidiary" in the CO will make off-balance sheet treatment very difficult and have negative impact on the development of Hong Kong's mortgage-backed securitization (MBS) market. There are two points of concern: (a) The American, European and Australian Securitization Forums have been discussing with the IAS Board on modifications to IASs to facilitate off-balance sheet treatment for genuine MBS transactions involving special purpose entities (SPEs). There may be changes in IASs affecting the definition of "subsidiary" and other provisions in the CO in near future; and (b) The entrenchment of the definition of "subsidiary" in the CO will make Hong Kong less competitive vis-à-vis other countries, e.g. Australia and Singapore, which do not have entrenched definition	HKMC

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	on "subsidiary". Australia and Singapore have adopted IASs but have no intention to amend the definition of "subsidiary" in their legislation. ● There are three proposed options - (a) To expressly provide a carve-out from the definition of "subsidiary" for asset-securitization SPEs similar to the concept of the Qualifying SPE available under US accounting rules; or (b) The Hong Kong Institute of Certified Public Accountants (HKICPA) should consider possible amendments to HKSAs which would enable asset-securitization SPEs to use the UK's "linked-presentation" format for their accounts which could clearly disclose the effect of the securitization transaction on the originator's balance sheet. However, HKICPA is not receptive to the proposition to introduce "linked-presentation" in Hong Kong; or (c) As a result of discussion with trade forums, IASB is undertaking a review of IAS 27 and plans to publish draft amendments for consultation by mid-2005 (which will consider whether the revisions to the "control" model for subsidiaries should also be applied to SPEs). It is suggested that the proposed amendments in the Bill be deferred after assessing the effects of the IAS draft amendments on Hong Kong.	
4	***Contents of accounts and group accounts (clauses 3 and 5)***	
4.1	Agrees that having "true and fair view override" provisions will help avoid the possibility of including vehicles, such as special purpose entities and other off-balance sheet non-subsidiaries, into the group accounts.	AIA (HKB)
4.2	Supports the introduction of the "true and fair view override" provisions. However, in the absence of more specific guidance, the discretion for directors to apply the provisions may create problems or uncertainties on how such discretion should be exercised. It would be helpful if	Linklaters

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	HKICPA could provide practical guidelines on the application of the provisions before the implementation of the Bill.	
4.3	● The"true and fair view override" provisions in the Bill are derived from sections 226A and 227A of the UK Companies Act 1985. In the UK, there is authority which suggests that the effect of the provisions is limited only to matters of disclosure and does not enable a company to depart from other provisions of the Act (e.g. definitions) even though section 227A also has language that overrides other provisions of the Act. Therefore, if such interpretation is adopted in Hong Kong, then if accounting standards change in a manner which conflict with parts of the CO other than the Tenth Schedule and other matters of disclosure, the "true and fair view override" provisions will not enable a company to disregard the requirements of the CO and follow accounting standards. ● To address the above concern, it is proposed that amendments be made to expressly extend the overriding effect of the "true and fair view override" provisions to cover other sections in the CO, such as the definition section. ● There will be practical difficulties in using the "true and fair view override" provisions as - (a) Company directors will not make a decision to use the provisions lightly because they are obliged to present accounts in the format specified by the CO and would face heavy criminal liability for non-compliance; and (b) Even if company directors consider it necessary to use the provisions, it is questionable whether the company's auditor could be persuaded to endorse such departure from the requirements of the CO.	HKMC

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5	***Exclusion of subsidiaries from group accounts (clause 4)***	
5.1	● The following two conditions for exclusion of a subsidiary from the group accounts set out in the proposed new subsections (2A)(a) and (b) of section 124 of the CO have already been amended in IASs: Subsection (2A)(a) "sever long-term restrictions substantially hinder the exercise of the rights of holding company over the assets or management of the subsidiary" Subsection (2A)(b) "the interest of the holding company is held exclusively with a view to subsequent resale and the subsidiary has not been previously included in the group accounts prepared by the holding company" ● The condition for exclusion set out in the proposed new subsection (2A)(a) has been removed from IASs. ● The scope of the proposed new subsection (2A)(b) is less clear than that under IASs. The Basis for Conclusions accompanying IAS 27 clearly provides for exclusion of a subsidiary if "there is evidence that the subsidiary is acquired with the intention to dispose of it within 12 months and that management is actively seeking a buyer".	ACCA
5.2	● The conditions for exclusion of a subsidiary from the group accounts set out in the proposed new subsections (2A)(a) and (b) of section 124 are different from the following two conditions provided in HKAS 27: (a) "Control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its disposal within 12 months from acquisition"; and (b) "Management is actively seeking a buyer".	Lam & Co

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5.3	The condition for exclusion of a subsidiary from the group accounts set out in the proposed new subsection (2A)(a) of section 124 fails to identify who the decision-maker should be if such circumstances arise. The directors are given the right to form an opinion in relation to the exclusions listed in section 124(2). It would be clearer for the operation of section 124(2A)(a) if a similar right could be given to the directors.	Law Soc
6	***Particulars to be shown in company's accounts in relation to subsidiaries (clause 7)***	
6.1	● Under the proposed amended section 128(1)(b) of the CO, particulars to be shown in the group accounts in respect of a subsidiary include the country in which it is incorporated or established. There may not be a readily identifiable jurisdiction in which an undertaking is considered to have been established. It would be more meaningful to require the disclosure of the country in which the undertaking carries on business. ● Under section 128(1)(c) and (d), information about the nature and quantity of shares held in the subsidiary is required to be disclosed. The term "shares" is given an extended meaning in section 1(1) of the proposed new Twenty-Third Schedule to catch unincorporated bodies. Even if the extended definition of "shares" is applied to section 128(1)(c) and (d), it is still not clear on the extent and nature of information that is required to be disclosed in respect of an unincorporated body in terms of ownership.	Law Soc
7	***Power to amend the Twenty-Third Schedule to the CO (clause 13)***	
7.1	Under the proposed amended section 360(5) of the CO, the Financial Secretary may, by order published in the Gazette, amend the Twenty-Third Schedule. The Schedule is a substantive part of the CO and is of no less importance than the main body of the Ordinance. Any change to the Schedule should require legislative oversight.	Law Soc

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8	***Determination of the existence of a parent/subsidiary relationship (clause 18 (proposed new Twenty-Third Schedule))***	
8.1	● There are inconsistencies in the wordings regarding the determination of the existence of a parent/subsidiary relationship between section 2 of the proposed new Twenty-Third Schedule and IAS 27, as follows: (a) In determining whether control by a parent undertaking exists, IAS 27 refers to the power of governing the financial and operating policies of an entity; and (b) Under section 2(1)(c) of the proposed new Twenty-Third Schedule, the scope of such power is extended to having a "dominant influence over the subsidiary undertaking".	ACCA
8.2	● Under sections 2(1)(c) and 5 of the proposed new Twenty-Third Schedule, parent/subsidiary relationship is determined through the rights to exercise a "dominant influence" over another undertaking by virtue of the provisions contained in the undertaking's constitutional documents or a "control contract". There are two points of concern: (a) It is important to clarify whether more than one entity can exercise "dominant influence" over another undertaking in the Hong Kong context, e.g. through joint control; (b) Control contracts do not appear to be common in Hong Kong. They are more relevant to European companies (e.g. Germany companies) where entering into control contracts with subsidiaries is prevalent. It seems that the meaning of "control contract" under the Hong Kong provisions needs to be specifically considered.	Linklaters
8.3	● "Control contract" is defined in section 5(b)(ii) of the proposed new Twenty-Third Schedule as "a contract in writing conferring a right which is permitted by the law under which that undertaking is established". There are two points of concern:	Law Soc

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	(a) There may not be a readily identifiable jurisdiction in which the undertaking is considered to have been established. Take partnership as an example, it is formed by contract and does not require registration to come into existence. A partnership may have a presence in one or more jurisdictions in which it carries on business, but it cannot be said that in every case the partnership is established in the jurisdiction where it operates; and (b) The law under which the undertaking is established may be silent on whether a control contract is permissible. On the other hand, the law does not prohibit the entering into of such contracts. The use of the word "recognized" could perhaps clarify the intention of the provision.	
9	***Definition of parent and subsidiary undertakings (clause 18 (proposed new Twenty-third Schedule))***	
9.1	It is not necessary to introduce a definition for the term "undertaking" in section 1 of the proposed new Twenty-third Schedule. The proposed definition includes a body corporate, a partnership, and an unincorporated body carrying on a trade or business. These are not separate and distinct legal entities. If a company becomes a member or a partner in such undertakings in its own name, the undertakings are legally part of the company. If a company is involved in such undertakings through a nominee, the legal status is the same unless the beneficial interest of the company is deliberately concealed with fraudulent intentions. The proposed amendment remains ineffective if an undisclosed nominee or trustee is imposed between the company and the undertaking, similar to undisclosed nominee or trustee of shares in another company.	AIA (HKB)

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10	***Voting rights in undertaking (clause 18 (proposed new Twenty-third Schedule))***	
10.1	Under section 3(3) of the proposed new Twenty-Third Schedule, the voting rights in an undertaking referred to in subsection (1) shall be reduced by any rights held by the undertaking itself. The objective or intended effect of this provision is not at all apparent.	Law Soc
11	***Other suggestions related to the Bill***	
11.1	The Administration should review section 266 of the CO and section 50 of the Bankruptcy Ordinance, which are also related to the holding company and subsidiary, so as to plug the potential loopholes.	AIA (HKB)

Council Business Division 1
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